First Community Bancshares, Inc.

February 16, 2011

Board of Governors of the Federal Reserve System
Division of Reserve Bank Operations and Payment Systems
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Comment Letter-Regulation II, Debit Card Interchange Fees

Dear Federal Reserve Governors,

On behalf of First Community Bank, N. A., I am writing to you in response to the request for public comment on proposed new Regulation II, Debit Card Interchange Fees and Routing, as a result of the Durbin Interchange Amendment, hereafter referred to as the "Amendment". Respectfully, I must voice strong concerns regarding the Amendment provisions. From its inception, the interchange service has benefited merchants and consumers greatly, particularly in the areas of guaranteed payment, quick and efficient service, as well as protection from losses and fraud. Merchants have been able to take the risk off of their books, increase sales revenue and meaningfully reduce fraud and bankruptcy loss. As a result, banks bear the risks and costs of providing this valuable service. Our institutions pay for the cost of fraud losses, fraud prevention efforts, card issuance and reissuance (including merchant data breaches), a reliable network (available 24/7) that processes billions of transactions around the world each year, and for the development and maintenance of the customer relationship.

In this letter, I have highlighted First Community Bank's grave concern over several aspects of the Amendment.

- The true effect of the two-tier pricing system on community banks and their customers
- The consideration of growing costs associated with fraud monitoring, prevention, loss and reputational risk
- The true cost of a typical POS transaction
- The negative impact on consumers by price-setting

P. O. Box 989 □ One Community Place □ Bluefield, VA 24605-0989 □ Telephone: 304-323-6300 □ Fax 304-323-6492 □ www.fcbinc.com

Two-Tier Pricing System - First Community Bank is a consumer-friendly community bank, currently at $2.2 billion in assets. We serve working families and small businesses in 4 states, including Virginia, West Virginia, Tennessee and North Carolina. Currently, we have over 41,000 debit card customers who completed more than 8.6 million card transactions this past year.

With regard to the two-tier system, the marketplace will drive the fees, not the size of the banks. When banks with assets greater than $10 billion start cutting their fees to comply with the Amendment, community banks will be forced to match those cuts to remain competitive. Merchants will have an economic incentive to drive transactions to the lowest cost payment methods, which will be offered by the large banks. Like all other community banks, First Community does not have the scale of the larger banks and the huge cost of fraud monitoring and software upgrades will likely drive us and small community-based institutions like us out of the space, thereby decreasing market competition, as well as eliminating a viable option for consumers.

Growing Costs of Fraud Monitoring/Software Upgrade/Reputational Risk - While merchants create the opportunity for fraud, it is the banks that pay the price, literally. Hackers continue to increase their sophistication levels, which demands more expensive, sophisticated fraud tracking. This results in increased reimbursements for fraud losses to the consumer paid by financial institutions under current Regulation E rules. In addition to assessing the rising cost of fraud and fraud prevention programs, it is also critical to consider the vast differences and economies of scale of the financial institutions being reviewed. The large institutions have much larger card bases, more transaction volume and more sophisticated fraud tracking programs. Smaller institutions have fewer cards, less transactions and do not have the resources to install costly data fraud detection technology. In fact, at our bank, we spent over $400,000 last year on fraud prevention, losses and personnel expense associated with fraud. That category of costs alone represents $.05 per transaction, not considering the costs of direct processing and account maintenance. Like smaller banks, we cancel and reissue debit cards suspected of being compromised at a higher rate than the larger issuers. This limits large potential losses and protects the customer, but raises the fraud cost floor. It shows the percentage of expense related to fraud is higher for community bank issuers than it is for the smaller group of large banks that are being reviewed.

As stated above, when card data is compromised at a retailer or payment processor, card issuers often reissue the cards to limit large losses and better protect customers. The bank most often only receives information that a breach has occurred, not that the merchant suffered a security breach or failed to safeguard data. As a result, the customer only knows that there has been a breach and blames the bank, unaware that the bank was not at fault for the data compromise. Multiple card reissuances have resulted in customer attrition and credibility issues at the community bank level.

The True Cost of a Typical POS Transaction - The cost structure of a typical POS transaction is very complex and should be considered. There are countless routes and differing fees associated with the clearing of a transaction, which affects the actual cost.

Impact on Consumers by Price-Setting - There is no assurance in the proposed rule for government-set interchange fee caps that any of the savings for merchants will be shared with consumers. Historically, Australian retailers lobbied successfully for similar price-setting and the result ***was not*** lower prices for consumers as retailers promised; conversely, it resulted in a higher cost of credit – thus resulting in a shift of costs from merchants to consumers – which is bad for families and the economy overall.

Further, consider the impact on basic deposit services. Without the offsetting contribution from debit interchange fees, the price structure of basic deposit services will invariably rise as deposit institutions seek to cover those costs in other areas, including deposit service charges and maintenance fees. Already we are seeing the erosion and what could be the eventual disappearance of "free checking" services.

In response to your request for comment on interchange fee standards and a proposed cap, I ask you to strongly consider the above mentioned points in light of the unintended consequences of the Amendment. These aspects of the Amendment pose a very real impact to consumers, small businesses, and our communities. Given the gravity and immediacy of this impact, I respectfully ask you to delay your rulemaking, so that the widespread implications may be fully explored.

In summary, community banks, including First Community Bank, want to continue to provide excellent service and protection for our customers and the consumer population. Interchange income, or cost reimbursement, has allowed the banks to support the cost of providing a checking account, a valuable service to lower income consumers who rely on free or low-cost financial services. With the significant loss of revenue from the interchange proposal, community banks will be forced to raise fees to offset the lost contribution to the very costly infrastructure that supports these and other basic banking services.

On behalf of First Community Bank, I thank you for your consideration, review and revision of the Interchange Amendment, in light of the information outlined above.

Best Regards,

John M. Mendez
President and Chief Executive Officer